

to an individual's spouse or former spouse under a divorce or separation instrument described in subparagraph (A) of section 71(b)(2) shall not be considered a taxable transfer made by such individual notwithstanding any other provision of this subtitle, and such interest shall, after such transfer, be treated as a medical savings account with respect to which such spouse is the account holder.

"(8) TREATMENT AFTER DEATH OF ACCOUNT HOLDER.

"(A) TREATMENT IF DESIGNATED BENEFICIARY IS SPOUSE.—

If the account holder's surviving spouse acquires such holder's interest in a medical savings account by reason of being the designated beneficiary of such account at the death of the account holder, such medical savings account shall be treated as if the spouse were the account holder.

"(B) OTHER CASES.—

"(i) IN GENERAL.—If, by reason of the death of the account holder, any person acquires the account holder's interest in a medical savings account in a case to which subparagraph (A) does not apply—

"(I) such account shall cease to be a medical savings account as of the date of death, and

"(II) an amount equal to the fair market value of the assets in such account on such date shall be includible if such person is not the estate of such holder, in such person's gross income for the taxable year which includes such date, or if such person is the estate of such holder, in such holder's gross income for the last taxable year of such holder.

"(ii) SPECIAL RULES.—

"(I) REDUCTION OF INCLUSION FOR PRE-DEATH EXPENSES.—

The amount includible in gross income under clause (i) by any person (other than the estate) shall be reduced by the amount of qualified medical expenses which were incurred by the decedent before the date of the

decedent's death
and paid by such person within 1 year
after such
date.

"(II) DEDUCTION FOR ESTATE TAXES.—

An appropriate deduction shall be allowed
under section 691(c) to any person (other than
the decedent
or the decedent's spouse) with respect
to amounts
included in gross income under clause
(i) by such
person.

"(a) ~~COST-OF-LIVING~~ ADJUSTMENT.—In the case of any
taxable
year beginning in a calendar year after 1998, each
dollar amount
in subsection (c)(2) shall be increased by an
amount equal to—

"(1) such dollar amount, multiplied by

"(2) the cost-of-living adjustment determined under
section

1(a)(3) for the calendar year in which such taxable
year begins

by substituting "calendar year 1997" for "calendar
year 1992"

in subparagraph (B) thereof.

If any increase under the preceding sentence is
not a multiple
of \$50, such increase shall be rounded to the
nearest multiple
of \$50.